

## SENATE FISCAL AGENCY MEMORANDUM

**DATE:** August 4, 2008

**TO:** Members of the Senate

**FROM:** Gary S. Olson, Director

**RE:** Financial Status of Detroit Public Schools

During the recent Senate debate on the FY 2008-09 K-12 School Aid appropriation bill, considerable discussion involved the financial status of the Detroit Public Schools (DPS). This memorandum provides the members of the Senate with background information concerning the DPS. Included in the memorandum are data on the recent financial history of the DPS, the current status of the DPS budget, and a discussion involving the issues related to the definition of a first class school district and the potential impact of this definition on the DPS.

### Recent Financial History of DPS

The Detroit Public Schools are currently governed by an 11-member Board of Education, elected by the voters of the school district. During the period from April 1999 through October 2004, the DPS was governed by a seven-member Reform Board pursuant to Public Act 451 of 1999. This Reform Board included six members appointed by the Mayor of the City of Detroit and one member appointed by the Governor. Prior to April 1999, the DPS was governed by a locally elected Board of Education.

Table 1 provides a history of audited DPS revenue and expenditures for the period FY 1994-95 through FY 2006-07. The data are from the DPS Annual Financial Reports. The data include revenue and expenditures for operational purposes and do not include debt service or capital outlay revenue or expenditures. During this 13-fiscal year period, actual annual DPS revenue exceeded annual expenditures during four fiscal years. The most recent fiscal year in which the DPS annual revenue exceeded annual expenditures was FY 2001-02. During the other nine fiscal years included in Table 1, annual DPS expenditures exceeded annual revenue. During the most recent audited year, FY 2006-07, DPS expenditures exceeded revenue by \$17.2 million.

At the close of FY 2003-04, the DPS received approval from the State of Michigan to refinance \$210.0 million of short-term State Aid Anticipation Notes outstanding as long-term debt payable over 15 years. The repayment of this long-term borrowing began during FY 2006-07. As a part of the conditions for the State of Michigan approval of this borrowing, the DPS agreed to maintain a positive General Fund balance. The DPS also agreed to make its finances subject to a Fiscal Review Committee designated by the State Treasurer. This Fiscal Review Committee currently consists of staff from the Michigan Department of Education, the Office of the State Budget, and the Department of Treasury. The Fiscal Review Committee is responsible for monitoring the finances of the DPS.

**Table 1**

<b>Detroit Public Schools Financial Data - Operating Revenue and Expenditures (millions of dollars)</b>			
<b>Fiscal Year</b>	<b>Revenue</b>	<b>Expenditures</b>	<b>Revenue Less Expenditures</b>
1994-95	\$1,198.4	\$1,210.7	\$(12.3)
1995-96	1,298.0	1,326.1	(28.1)
1996-97	1,325.2	1,275.6	49.6
1997-98	1,359.7	1,291.0	68.7
1998-99	1,406.3	1,382.3	24.0
1999-2000	1,431.0	1,439.7	(8.7)
2000-01	1,454.6	1,490.8	(36.2)
2001-02	1,664.7	1,606.4	58.3
2002-03	1,688.9	1,696.0	(7.1)
2003-04	1,665.4	1,777.4	(112.0)
2004-05	1,598.4	1,676.9	(78.5)
2005-06	1,553.9	1,588.2	(34.3)
2006-07	1,556.5	1,573.7	(17.2)

**Source:** Detroit Public Schools Annual Financial Reports. Operating Expenditures are total expenditures less debt service and capital outlay

A significant decline in the number of pupils in the school district has contributed to the financial stress facing the DPS. This decline in pupils has an impact on the level of per-pupil State funding received by the DPS. Table 2 provides a summary of the pupil membership in the DPS for the period FY 1994-95 through FY 2008-09. The FY 2008-09 estimate is the estimate used by the State during the Consensus Revenue Estimating Conference held in May 2008. During this 15-fiscal year period, the DPS peaked at 173,871 pupils in FY 1997-98. By FY 2007-08, the number of pupils had declined to 106,485. This represents a decline of 67,386 pupils or 38.8%. During FY 2008-09, the number of pupils in the DPS is expected to drop again to a level of 96,194.

**Table 2**

<b>Detroit Public Schools - Annual Pupil Memberships</b>		
<b>Fiscal Year</b>	<b>Pupil Memberships</b>	<b>Change from Prior Year</b>
1994-95	167,481	549
1995-96	169,996	2,515
1996-97	173,080	3,084
1997-98	173,871	791
1998-99	173,848	(23)
1999-2000	168,213	(5,635)
2000-01	162,693	(5,520)
2001-02	159,694	(2,999)
2002-03	157,003	(2,691)
2003-04	150,415	(6,588)
2004-05	141,148	(9,267)
2005-06	130,719	(10,429)
2006-07	117,601	(13,118)
2007-08	106,485	(11,116)
2008-09 Estimated	96,194	(10,291)

**Source:** Senate Fiscal Agency data

The pupil decline in the DPS reduced the level of revenue available to support the operation of the district. Based on the State per-pupil funding received by the DPS during FY 2007-08, the 67,386 decline in the number of pupils since FY 1997-98 equates to a loss of approximately \$510.0 million of annual revenue. This revenue loss represents approximately one-third of the current operating revenue of the DPS.

The DPS, like many other local school districts across the State, is faced with the dilemma of having to adjust operating expenditures to keep a balanced budget in light of declining enrollments and limited increases in the per-pupil funding levels provided by the State. Due to the fact that the State funds local school districts on a per-pupil basis, one would expect that a school district's operating expenditures per pupil should track closely with the increase in the per-pupil foundation allowance. If this is not occurring, it is likely that a local school district is facing an imbalance between operating revenue and expenditures.

Table 3 illustrates this situation in the DPS. The table provides a summary of the foundation allowance per pupil received by the DPS from the State and the operating expenditures per pupil in the district. Comparing FY 2006-07 with the peak year in pupils, FY 1997-98, the per-pupil foundation allowance funding increased by 25.1% over this nine-fiscal year period. During the same nine-fiscal year period, the operating expenditures per pupil in the district have increased by 80.2%. The result of this growth in operating expenditures per pupil exceeding the growth in the per-pupil funding received by the DPS from the State has resulted in annual DPS operating expenditures exceeding operating revenue in recent years.

<b>Table 3</b> <b>Detroit Public Schools</b> <b>Foundation Allowance and Per-Pupil Expenditures</b>		
<b>Fiscal Year</b>	<b>Foundation Allowance</b>	<b>Expenditures Per Pupil</b>
1994-95	\$5,584	\$7,228.9
1995-96	5,737	7,800.8
1996-97	5,892	7,370.0
1997-98	6,046	7,425.0
1998-99	6,046	7,951.2
1999-2000	6,284	8,558.8
2000-01	6,584	9,163.3
2001-02	6,884	10,059.2
2002-03	7,180	10,802.3
2003-04	7,180	11,816.6
2004-05	7,180	11,880.4
2005-06	7,355	12,149.7
2006-07	7,565	13,381.7
<b>Dollar Change</b>		
FY 2006-07 from FY 1997-98	\$1,519.0	\$5,956.6
<b>Percentage Change</b>		
FY 2006-07 from FY 1997-98	25.1%	80.2%

**Source:** Senate Fiscal Agency calculations

The future financial health of the DPS will likely hinge on the district's ability to reduce expenditures fast enough to keep up with an ongoing decline in pupils. This financial stress will continue unless the DPS develops additional revenue sources or takes actions that would result in leveling off the number of pupils in the district. Absent additional revenue or a leveling-off in the pupil count, the DPS will be forced to make significant reductions in expenditures to ensure a balance between annual revenue and expenditures.

### **Current Status of the DPS Budget**

Pursuant to provisions of State law, public school districts in Michigan are required to approve an annual budget no later than June 30 of each year. The Detroit Board of Education approved a budget for FY 2008-09 on June 30, 2008. This approved budget attempts to eliminate a projected FY 2008-09 budget deficit of approximately \$408.0 million over the next two fiscal years. This deficit projection includes both the annual imbalance between projected FY 2008-09 operating revenue and expenditures and a negative operating balance carried forward from FY 2007-08.

Based on discussions with the DPS, the enacted budget will lead to a \$104.7 million operating deficit at the close of FY 2008-09 but will result in a \$2.6 million operating surplus at the close of FY 2009-10. The DPS is currently in the process of releasing to the public the details of this two-year deficit-elimination budget plan. Eliminating a projected \$408.0 million budget deficit over two fiscal years will involve significant reductions in expenditures. Based on the audited FY 2006-07 expenditure level of \$1.57 billion, a \$408.0 million reduction in spending over two fiscal years equates to a 26.0% reduction in expenditures. The Senate Fiscal Agency will provide the Senate with the details of these proposed expenditure reductions when the details are released by the DPS.

The budget deficit that DPS is currently dealing with has led to cash-flow problems in the school district. As a result of its cash-flow problems, the DPS requested that the State advance State school aid payments to the district earlier than is normally provided under the State School Aid Act. The Act provides that local school districts will receive their State aid payments not later than the 20<sup>th</sup> day of each month. The payments are made over 11 months with no payment made during September. The Act does allow a local school district to request an advance release of State aid payments to deal with a cash-flow problem of a temporary and nonrecurring nature. The advance payments, if authorized by the State, may not be paid more than 30 days before the regularly scheduled payment dates.

On June 24, 2008, the DPS requested that the State advance State aid payments to the district to alleviate a cash-flow problem. The advance of the State aid payments to the DPS was approved by the State Superintendent of Public Instruction, the State Treasurer, and the Director of the Office of State Budget on June 27, 2008. The scheduled July 20 payment was advanced to July 7 and the scheduled August 20 payment was advanced to July 21. This advance of State aid payments was necessary to provide the DPS with adequate cash to make payments on payroll-related costs, to employees of the DPS, in a timely manner. The DPS on June 20, 2008, sent a letter to private vendors that have contractual agreements with the school district, notifying them that it would be unable to make payments owed to private vendors within the normal payment policy of within 30 days of receiving the invoice for services provided. The

DPS is currently pursuing options involving borrowing from private financial institutions in order to make payments owed to private vendors.

### **Definition of a First Class School District**

The fact that the State is projecting that the pupil membership in the DPS will be dropping to 96,194 during the FY 2008-09 school year leads to another potential State policy issue involving the DPS. Prior to the passage of Senate Bill 1107, the FY 2008-09 State School Aid Act appropriation bill, the only definition of a first class school district was found in the Revised School Code (RSC). The RSC is a separate statute governing many aspects of school districts, intermediate school district, charter schools, elections, school bonding and other school issues. The definition of a first class school district is found in the RSC at MCL 380.402, and is as follows:

"Sec. 402. A school district that has a pupil membership of at least 100,000 enrolled on the most recent pupil membership count day is a first class school district governed by this part."

The DPS is the only local school district in the State that meets the definition of a first class school district. Enrolled Senate Bill 1107 includes, for the first time, a definition of a first class school district in the State School Aid Act. The definition of a first class school district in the bill is a district of greater than 60,000 pupils. This new definition of a first class district in the SSAA would allow the DPS to continue to use certain provisions of the Act even if the number of pupils in the DPS drops under 100,000. These provisions include:

- Sec. 18: Allows a district of the first class to use the auditor of the City as its financial auditor.
- Sec. 25b: Provides a threshold for districts that are not first class districts that must be attained before being allowed to count pupils who enroll after the count day, and receive prorated funding.
- Sec. 25c: Provides a different threshold for a district of the first class that must be attained before being allowed to count pupils who enroll after the count day, and receive prorated funding.
- Sec. 31a: Allows a district of the first class to use up to 15% of at-risk funds for school security.
- Sec. 64: Allows a district of the first class (in addition to intermediate school districts) to compete for health/science middle college grants.
- Sec. 166e: Requires competitive bidding of contracts for a district of the first class.

This change in the definition of a first class school district contained in Senate Bill 1107 should not have an impact on the level of Federal funds received by the DPS. According to the Michigan Department of Education, Federal funding for the DPS does not depend upon any State definition of it being or not being a school district of the first class. Federal funding is governed by Federal rules; it is possible that the DPS, simply by virtue of losing students, will see decreased Federal funding, but that has nothing to do with any State definition of first class status.

The definition of a first class school district contained in Senate Bill 1107 does not apply to Sec. 6(6)l of the State School Aid Act. This section allows a district of the first class, as continued to be defined in the RSC as one with at least 100,000 pupils, to veto or prohibit another school from opening up a school district within the first class district's boundaries. Therefore, if or when the DPS falls below 100,000 pupils, it will lose its ability to veto or prohibit other districts from opening up a school within the boundaries of the DPS.

The change in the definition of a first class school district contained in the Act results in a different definition of a first class school district in the State School Aid Act and the Revised School Code. All of the sections of the RSC that mention a first class district remain bound by the definition in Sec. 402 of the Code. For example, the section of the RSC that prohibits community colleges from authorizing a charter school to open within the boundaries of a first class district still applies only to a first class district with over 100,000 pupils. Therefore, absent a statutory change in the definition of a first class school district in the RSC, community colleges will be free to open charter schools within the boundaries of the DPS when the enrollment of the DPS drops under 100,000 pupils.

I hope that this background information answers some of the questions that Senators have raised with the Senate Fiscal Agency regarding the financial status of the DPS. If you have any questions on these issues, please contact my office.

/kjh

c: Ellen Jeffries, Deputy Director